ORIGINAL

RECEIVED

MAR 13 1996

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

**Before the**
**FEDERAL COMMUNICATIONS COMMISSION**
**Washington, D.C. 20554**

| | |
|---|---|
| **In The Matter of**<br><br>**Bell Operating Company Provision of Out-of-Region Interstate, Interexchange Services** | **CC Docket No. 96-21** |

DOCKET FILE COPY ORIGINAL

# COMMENTS OF THE TELECOMMUNICATIONS RESELLERS ASSOCIATION

**TELECOMMUNICATIONS RESELLERS ASSOCIATION**

**Charles C. Hunter**
**HUNTER & MOW, P.C.**
**1620 I Street, N.W.**
**Suite 701**
**Washington, D.C. 20006**
**(202) 293-2500**

**March 13, 1996** **Its Attorneys**

No. of Copies rec'd 029
List ABCDE

## TABLE OF CONTENTS

# SUMMARY

The Telecommunications Resellers Association ("TRA"), an organization consisting of more than 450 resale interexchange and other carriers and their underlying service and product suppliers, applauds the Commission for recognizing that the RBOCs retain monopoly, or near monopoly, control of local exchange/ exchange access "bottlenecks" and for tentatively concluding that the RBOCs should continue to be classified as dominant in all aspects of their telecommunications operations. For much the same reason, TRA believes that RBOC interexchange affiliates, even if limited to the provision of out-of-region long distance services, should be regulated as dominant until such time as the local exchange/ exchange access "bottlenecks" have been dismantled and, accordingly, urges the Commission to refrain from classifying as non-dominant even structurally separate RBOC out-of-region long distance services affiliates.

Each of the RBOCs is in a position to leverage its respective "bottleneck" power to disadvantage competing providers of long distance telecommunications services that are dependent on it for access within that RBOC's local exchange service area in ways that would injure those entities in the national interstate, interexchange telecommunications market. And, of course, the potential for misallocation of costs and/or assets between competitive and monopoly activities is not eliminated by differentiating between out-of-region and in-region long distance services. Moreover, RBOC affiliates will be permitted to offer long distance services within and without the RBOCs' respective local exchange service areas if such services are offered in conjunction with CMRS services, implicating the "mobile bottleneck."

If, however, the Commission ultimately decides to regulate RBOC provision of out-of-region long distance services as non-dominant, TRA endorses the Notice's proposal to reserve such relaxed regulation to structurally-separate affiliates that, at a minimum, satisfy the Commission's Competitive Carrier separation requirements. TRA urges the Commission, however, to strengthen the applicable separation requirements in order to ensure that the separation between the RBOCs and their out-of-region long distance service affiliates is meaningful. Specifically, TRA recommends that the Commission (i) require separation of the credit underlying the out-of-region long distance services affiliate from that which supports the RBOC and in so doing prohibit credit arrangements which would allow recourse to the assets of the RBOC in association with funding provided to the out-of-region long distance affiliate; (ii) prohibit the sharing of office space and personnel, requiring the RBOC and the out-of-region long distance services affiliate to maintain separate offices and to hire/appoint separate officers, directors and employees; and (iii) prohibit the sharing of customer proprietary network information and other confidential information obtained solely by virtue of either the RBOC's or the out-of-region long distance services affiliate's role as a provider of telecommunications services.

**Before The**
**FEDERAL COMMUNICATIONS COMMISSION**
**Washington, D.C. 20554**

| | | |
|---|---|---|
| **In The Matter of** | ) | |
| | ) | |
| **Bell Operating Company** | ) | **CC Docket No. 96-21** |
| **Provision of Out-of-Region** | ) | |
| **Interstate, Interexchange Services** | ) | |

# COMMENTS OF THE TELECOMMUNICATIONS RESELLERS ASSOCIATION

The Telecommunications Resellers Association ("TRA"), by its attorneys and pursuant to Section 1.415 of the Commission's Rules, 47 C.F.R. § 1.415, hereby submits its Comments in response to the Notice of Proposed Rulemaking in the captioned proceeding, FCC 96-59 (released February 14, 1996) (the "Notice"). In this docket, the Commission will determine the regulatory classification, and hence the regulatory treatment, of the Regional Bell Operating Companies ("RBOCs") in their provision of interstate, interexchange services originating outside of their local exchange service areas ("out-of-region long distance services").[1]

The Commission has tentatively concluded that the RBOCs should be classified as "dominant" in their provision of out-of-region long distance services unless they elect to provide such services through structurally-separate affiliates in conformance with the separation

---

[1] The Commission has properly excluded from its definition of "out-of-region long distance services" all services that both terminate in an RBOC's local exchange service area and allow the called party to determine the interexchange carrier -- *i.e.,* 800 service, private line service and their equivalents. The Commission, however, has included in such definition long distance services offered by the RBOCs in conjunction with their provision of commercial mobile radio service ("CMRS").

requirements mandated in the Commission's Competitive Carrier proceedings.[2] If the RBOCs provide out-or-region long distance services through such structurally-separate affiliates, the Commission has tentatively concluded that these entities should be classified as "non-dominant" for federal regulatory purposes.[3]

TRA applauds the Commission for recognizing that the RBOCs retain the ability to leverage their market power in the local exchange/exchange access market to disadvantage competing providers of interexchange services and for tentatively concluding that the RBOCs should continue to be classified as dominant in all aspects of their telecommunications operations. For much the same reason, TRA believes that RBOC interexchange affiliates, even if limited to the provision of out-of-region long distance services, should be regulated as dominant until such time as the RBOCs no longer possess monopoly, or near monopoly, control of local exchange/ exchange access "bottlenecks". If, however, the Commission ultimately decides to regulate RBOC provision of out-of-region long distance services as non-dominant, TRA endorses the Notice's proposal to reserve such relaxed regulation to structurally-separate affiliates that, at a minimum, satisfy the Commission's Competitive Carrier separation requirements. TRA urges the

---

[2] Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Therefor, First Report and Order, 85 F.C.C.2d 1, ¶ 54 (1980); Second Report and Order, 91 F.C.C.2d 187 (1982), recon. denied, 93 F.C.C.2d 54 (1983); Third Report and Order, 48 Fed. Reg. 46,791 (1983); Fourth Report and Order, 95 F.C.C.2d 554 (1983), rev'd and remanded sub nom., American Tel. & Tel. v. FCC, 978 F.2d 7272 (D.C.Cir. 1992), cert. denied, 113 S.Ct. 3020 (1993); Fifth Report and Order, 98 F.C.C.2d 1191 (1984); Sixth Report and Order, 99 F.C.C.2d 1020 (1985), rev'd and remanded sub nom., MCI Telecommunications Corp. v. FCC, 765 F.2d 1186 (D.C.Cir. 1985).

[3] The non-dominant classification would, however, apply only to the structurally-separate affiliates' provision of out-of-region long distance services and not to interstate, interexchange services originating within an RBOC's local exchange service area.

Commission, however, to strengthen the applicable separation requirements in order to ensure that the separation between the RBOCs and their out-of-region long distance service affiliates is meaningful.

# I.

# INTRODUCTION

TRA's interest in this proceeding is in protecting, preserving and promoting competition within the interstate, interexchange telecommunications services market in which most of TRA's resale carrier members participate through the resale of the network switching and/or transmission services of underlying facilities-based carriers, as well as in speeding the emergence and growth of facilities-based and resale competition in the local exchange/exchange access market. Since its inception, TRA has been a champion of competition in the telecommunications industry, first with respect to domestic interexchange services, and more recently, with regard to international, local exchange, wireless, internet and other diverse services.

TRA was created, and carries a continuing mandate, to foster and promote the interests of entities engaged in the resale of telecommunications services. Employing the transmission, and often the switching, capabilities of underlying facilities-based network providers, the resale carriers comprising TRA create "virtual networks" to serve generally small and mid-sized commercial, as well as residential, customers, providing such entities and individuals with access to rates otherwise available only to much larger users. TRA resale carrier member also offer small and mid-sized commercial customers enhanced, value-added products and services, including a variety of sophisticated billing options, as well as personalized customer support functions, that are generally not made available to low-volume users.

TRA's members -- more than 450 resale carriers and their underlying service and product suppliers -- range from emerging, high-growth companies to well-established, publicly traded corporations.[4] While the bulk of TRA's resale carrier members are not yet a decade old, they collectively generate annual revenues in the billions of dollars. The emergence and dramatic growth of TRA's resale carrier members over the past five to ten years have produced thousands of new jobs and new commercial opportunities. In addition, TRA's resale carrier members have facilitated the growth and development of second- and third-tier facilities-based interexchange carriers by providing an extended, indirect marketing arm for their services, thereby further promoting economic growth and development. And perhaps most critically, by providing cost-effective, high quality telecommunications services to the small business community, TRA's resale carrier members have helped other small and mid-sized companies expand their businesses and generate new employment opportunities.

In TRA's view, market forces are, all things being equal, generally superior to regulation in promoting the efficient provision of diverse and affordable telecommunications products and services. TRA is well aware, however, that the emergence, growth and development of a vibrant telecommunications resale industry is a direct product of a series of pro-competitive initiatives undertaken, and pro-competitive policies adopted, by the Commission over the past

---

[4] TRA numbers among its members not only entities engaged in the resale of interexchange, international, local, wireless and internet services, but facilities-based interexchange carriers, foreign facilities-based carriers, RBOCs, independent telephone companies, competitive access providers ("CAPs"), and CMRS providers.

decade. TRA thus understands that the market is an effective regulator only if market forces are adequate to discipline the behavior of all market participants. If one or more such participants are possessed of market power sufficient to exert control over the market, thereby impeding the competitive provision of service, regulatory intervention is essential to protect the public interest.

While competition -- though far from perfect -- has emerged in the interstate, interexchange services market, the local exchange remains essentially the monopoly preserve of the RBOCs and other local exchange carriers ("LECs"). This "bottleneck" control provides the RBOCs with the ability to act anticompetitively to disadvantage competing providers of interstate, interexchange services, even if the RBOCs were to act through structurally-separate subsidiaries and were to provide only out-of-region long distance services. Whether the anticompetitive conduct takes the form of discriminatory access or other strategic price or service manipulation or misallocation of costs and/or assets from competitive to monopoly activities or other cross-subsidization, the result will be the same -- competition in the interstate, interexchange market will be adversely impacted and it is the smaller carriers that comprise the rank and file of TRA's membership that will be most directly impacted and most seriously harmed.

Accordingly, TRA urges the Commission to refrain from classifying as nondominant even structurally-separate RBOC out-of-region long distance services affiliates until such time as the local exchange/exchange access "bottleneck" has become a thing of the past. Premature relaxation of regulation of the RBOCs before meaningful local exchange/exchange access competition develops will only serve to delay, and perhaps stifle, nascent local competition and dampen existing interexchange competition. Nonetheless, TRA applauds the Commission's recognition that if regulation of RBOC provision of out-of-region long distance services is to be relaxed, such relaxation should be limited to structurally-separate affiliates. It is critical, however, that such separation be meaningful and strictly controlled and enforced.

## II.

## ARGUMENT

### A. The RBOCs Should Not Be Afforded Non-dominant Treatment Until Such Time As The Local Exchange/ Exchange Access "Bottlenecks" No Longer Exist

#### 1. The RBOCs Retain Monopoly, Or Near Monopoly, Control Of Local Exchange/Exchange Access "Bottlenecks"

The newly-enacted Telecommunications Act of 1996 ("'96 Act") has eliminated all legal barriers to local exchange/exchange access competition.[5] The '96 Act further provides for the dismantling of many of the practical barriers to local competition by mandating, among other things, the deployment and/or availability of number portability, intraLATA dialing parity, unbundled access to network elements, collocation, reciprocal compensation arrangements, access to rights-of-way and unlimited resale.[6] "Contestable" markets, however, should not be confused with "contested" markets; while competitive potential may ultimately evolve into actual competition significant enough to discipline market power, the lag in time before competition actually emerges may, and likely will, be substantial. It belabors the obvious to suggest that the

[5] Pub. L. No. 104-104, 110 Stat. 56, § 253 (1996).

[6] Id. at §§ 251, 271(c)(2)

local exchange/exchange access market cannot be deemed competitive merely because competition is no longer legally prohibited.[7]

As the Commission itself has observed, "the LECs continue to exercise a substantial degree of market power in virtually every part of the country, and continue to control bottleneck facilities."[8] Thus, in addressing the state of competition in one of the nation's largest metropolitan areas, the Commission recently acknowledged that "actual competition does in fact remain quite limited -- most customers in most of the Chicago LATA are still unable to choose the services of a competing provider of local exchange services."[9] And as the Commission has recently recognized, "the transformation from monopoly to fully competitive markets will not take place overnight."[10] The Commission has corrected noted that in addition to legal and regulatory barriers, "there are also substantial technical and economic barriers to entry in local exchange markets" and that as a result, "LECs in most parts of the country continue to exercise market power in the provision of both intrastate local exchange service and the local switching

---

[7] In the view of the United States Department of Justice ("DOJ"), "[i]t is hard to think of a market less likely to be 'contestable' than local exchange service." "Memorandum of the United States in Support of Its Motion for a Modification of the Decree to Permit a Limited Trial of Interexchange Service by Ameritech" filed in United States v. Western Electric Co., Civ. Action No. 82-0192 (HHG) on May 1, 1995 at p. 31 ("DOJ Memorandum").

[8] Price Cap Performance Review for Local Exchange Carriers (First Report and Order), 10 FCC Rcd. 8961 (1995) at 9122, ¶ 368; id. at 9143, ¶ 418 ("[t]he record in this proceeding does not support a finding that competition for LEC services is sufficiently widespread to constrain the pricing practices of LECs for new services."); Notice at ¶ 9.

[9] Ameritech Operating Companies: Petition for Declaratory Ruling and Related Waivers to Establish a New Regulatory Model for the Ameritech Region, FCC 96-58, ¶ 77 (released Feb. 15, 1996). Moreover, the Commission noted that "as of January 15, 1996, no unbundled loops had been sold in Chicago."

[10] Id. at ¶ 130.

and common line components of interstate switched access service."[11] For these reasons, the Commission has been adamant in refusing to relax regulation "solely on the basis of market contestability."[12]

While stressing that the "seeds of local competition are widespread," the Common Carrier Bureau has acknowledged that "the development of competition in local services is roughly a dozen years behind the development of competition in long distance."[13] According to the Common Carrier Bureau's Fall, 1995 "Common Carrier Competition" report, only four states had what the report characterizes as "active competition in switched local service."[14] Of the 31 states in which local competition was then permitted, 20 had not adopted implementing regulations, three more had yet to certify competing providers and in four more competing local service providers had yet to commence operations. In any given geographic market, therefore, the incumbent LEC continues to be the primary, if not the sole, source of the connectivity that allows consumers within that market to communicate by telephone.

---

[11] Id. at ¶ 66; id. at ¶ 65 ("[I]t is difficult for local exchange competition to emerge even in the absence of legal prohibitions because there are no arrangements in place governing the technical and financial aspects of interconnection between competing networks") and ¶ 72 ("[T]he development of the facilities necessary to provide competitive exchange and access services requires significant investment"); *see also* United States v. Western Electric Co., 673 F.Supp. 525, 543-44 (D.D.C. 1987), *aff'd in relevant part*, 900 F.2d 283 (D.C.Cir.), *cert denied*, 498 U.S. 911 (1990).

[12] Id. at ¶ 72.

[13] Common Carrier Bureau, "Common Carrier Competition" (Spring, 1995) ("Spring Competition Report") at 5.

[14] Common Carrier Bureau, "Common Carrier Competition" (Fall, 1995) ("Fall Competition Report") at 4. Information about local competition in the Fall Competition Report was provided as of September 1, 1995.

With respect to exchange access, IXCs still rely on franchised LECs to originate and terminate more than 95 percent of their traffic. Indeed, in its Spring, 1995 "Common Carrier Competition" report, the Common Carrier Bureau found that the LECs "continue to account for 97% of access revenues -- a level roughly comparable to the Bell System's share of toll revenues in 1981."[15] The limited exchange access competition that the LECs now face tends to be geographically-confined niche competition, which at most "selectively impact[s] growth of demand of the local telephone companies."[16] The fiber deployed by competitive access providers ("CAPs") is but a small fraction of the fiber deployed by the RBOCs.[17] CAPs, according to the Bureau, "remain tiny compared to the local exchange carrier industry . . . [i]ndeed, alternative local service providers still account for less than one percent of access revenues."[18] CAP facilities, where available, are still used principally for redundancy.[19]

---

[15] Spring Competition Report at 5.

[16] Kraushaar, J.M., Fiber Deployment Update: End of Year 1994 (July 12, 1995) ("Fiber Deployment Update (1994)"). Confirming this point is the fact that the LECs have experienced an annual growth rate of roughly seven percent in access traffic volumes over the past years. In commenting on the impact of competitive access providers ("CAPs"), DOJ suggests that "competition from CAPs has just begun to develop." DOJ Memorandum at p. 5.

[17] Id. And while the CAPs may have installed a not insignificant amount of fiber during 1994, the major LECs were installing a comparable level of fiber every two months. Fiber Deployment Update (1994); P. Montgomery, "Tough Road for Competition in Local Switched Service," Business Communications Review, Vol. 25, No. 3, p. 53 (March, 1995).

[18] Spring Competition Report at 5.

[19] "The companies typically have offered non-switched services initially, and although they provide end user to end user links, most of their business is either for customer access to a long distance carrier or for links between interexchange carrier points-of-presence." Fiber Deployment Update (1994).

The reality then is that the LECs retain monopoly, or near monopoly, control of local exchange "bottlenecks" and do not now face, and are unlikely to face in the immediate near future, any meaningful competition in their provision of local exchange/exchange access services. Wireline competitors are only beginning to enter the market. And while cellular radio, personal communications services and other wireless offerings and cable television may provide viable competitive alternatives at some point in the future, that day has not yet arrived, and will likely not arrive, if at all, for years to come.[20] As described in The Enduring Local Bottleneck:

---

[20] Cellular service supplements rather than replaces local telephone service. Not only do the overwhelming majority of cellular calls transit the local exchange network, but the costs to consumers of cellular service are significantly more expensive than local telephone service. Confirming that cellular service supplements rather than replaces local telephone service is the simple fact that the impressive growth in cellular demand has not adversely affected RBOC profitability. Moreover, it must be borne in mind that the RBOCs and GTE Telephone represent eight of the nine largest cellular operators in the country.

Personal communications service ("PCS") may someday fulfill the vision of its most ardent proponents and render the wireline network superfluous at least in part, but at this juncture any claims regarding the potential competitive impact of PCS on the local "bottleneck" are grossly speculative. PCS is still in its infancy. PCS service is currently available only in one market. Widespread PCS system construction and service implementation are likely years away. Moreover, like cellular telephone, many, if not most, PCS applications will rely heavily on the local telephone network and, like cellular telephone, many PCS licenses will be held by RBOCs.

> Despite optimistic predictions that PCS will conquer the local loop, there is evidence that it will be more of an adjunct than a replacement for landline networks. But even the successful PCS raider, who wants only piece of the local exchange action, faces huge obstacles.

"Raiders of the Local Loop: PCS & Local Competition," PCS Week, vol. 6, no. 41 (October 25, 1995) ("Raiders of the Local Loop").

Reliance upon the potential competitive threat of cable television ("CATV") is no less speculative. At present, the overwhelming majority of CATV systems lack the two-way transmission and switching capability necessary to provide competitive telecommunications

Footnote continued on next page

> Expansion of alternative access provider services, FCC mandated interconnection requirements, the growing use of wireless service, even multi-billion dollar alliances between traditional telecommunications carriers and potential future alternative local service providers, have all contributed to a perception that local competition has arrived. While these developments may have increased the prospects for competition, their actual economic impact on the traditional local exchange monopolies is, at the present time, far more smoke than fire. Furthermore, the enormous investments required to build alternative local networks across the country, the time it will take to win customers away from the incumbents, and the power of the dominant local exchange carriers to thwart competitive entry ensure that effective competition will not occur overnight.[21]

This assessment was recently reconfirmed in <u>The Enduring Local Bottleneck II: A Preliminary Assessment</u> published in January, 1996:[22]

> [T]he overall findings in the earlier report appear to be equally valid today. Local telephone company predictions about the imminent arrival of effective competition are as inaccurate today as they were two years ago. The degree of local competition is still trivial, as demonstrated by an analysis of structure, conduct and performance in the market. There have been no cost breakthroughs in the technologies available to competitors that would suggest the investment results found in [The Enduring Local Bottleneck] will substantially change. Nor have any hypothetical "volume production" cost reductions materialized, because these technologies are not yet in mass production.

---

Footnote continued from previous page

services. CATV systems served by coaxial cable have limited capacity for two-way transmission and will experience significant signal degradation and service disruptions if used for two-way transmission. While introduction of fiber optics transmission will alleviate these problems to some degree, it will not remedy them completely because coaxial cable is generally used to complete the transmission path to the home even in the more advanced systems. And at present, many CATV systems have not been enhanced by fiber. DOJ refers to competition from CATV provides as "largely a theoretical possibility." DOJ Memorandum at p. 5.

[21] Economics and Technology, Inc. and Hatfield Associates, Inc., <u>The Enduring Local Bottleneck: Monopoly Power and the Local Exchange Carriers</u>, at i-ii, (1994) ("<u>The Enduring Local Bottleneck</u>").

[22] Hatfield Associates, Inc., <u>The Enduring Local Bottleneck II: A Preliminary Assessment</u>, at ii, (1996) ("<u>The Enduring Local Bottleneck II</u>").

### 2. **RBOC Control Of Local Exchange/Exchange Access "Bottlenecks" Can Be Leveraged To Disadvantage Competitors Of RBOC Affiliates Providing Out-Of-Region Long Distance Services.**

For purposes of applying the dominant/non-dominant dichotomy, the Commission has determined that the interstate, interexchange telecommunications market is national in scope.[23] Hence, each of the RBOCs is in a position to leverage its respective "bottleneck" power to disadvantage competing providers of long distance telecommunications services that are dependent on it for access within that RBOC's local exchange service area in ways that would injure those entities in the national interstate, interexchange telecommunications market. And, of course, the potential for misallocation of costs and/or assets between competitive and monopoly activities is not eliminated by differentiating between out-of-region and in-region long distance services. Moreover, under the Commission's approach, RBOC affiliates would be permitted to offer long distance services within and without the RBOCs' respective local exchange service areas as non-dominant carriers if such services were offered in conjunction with CMRS services, implicating the "mobile bottleneck."

In the First Report and Order issued in its Competitive Carrier proceeding, the Commission cited three reasons for classifying AT&T as a dominant carrier, one of which was AT&T's "control of bottleneck facilities:"

---

[23] In the Matter of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, FCC 95-427 (released October 23, 1995) ("AT&T Non-dominance Order"); *see also* United States v. Western Electric Co., 673 F.Supp. 525, 543-44 (D.D.C. 1987), *aff'd in relevant part*, 900 F.2d 283 (D.C.Cir.), *cert denied*, 498 U.S. 911 (1990); United States v. Western Electric Co., 1989-1 Trade Cases (CCH) ¶ 68.619, 61,266 (D.D.C. June 11, 1989).

> Currently, the Bell System controls access to over 80% of the nation's telephones. Since many of AT&T's competitors must have access to this network if they are to succeed, AT&T possesses control of bottleneck facilities. Therefore, we believe that AT&T must be treated as dominant.[24]

While the individual RBOCs may only control between 5 and 15 percent of access lines nationwide, their control within their respective service areas exceeds the 80 percent figure referenced by the Commission above. And as the Notice correctly recognizes (at ¶ 12), both the RBOC out-of-region long distance services affiliate and the RBOCs' interexchange competitors will have to terminate calls over these in-region bottleneck facilities. "A Regional Company that competes against such providers everywhere except in its region would not find it difficult to discriminate against such a provider in its region, thereby damaging the competitor's service and reputation on a national basis."[25] Bottleneck control even within a confined geographic area provides an RBOC with the ability to not only interfere with a rival interexchange provider's customer relations, but to increase such a rival's costs of doing business both directly through

---

[24] 85 F.C.C.2d 1 at ¶ 62. As explained by the Commission: "An important structural characteristic of the marketplace that confers market power upon a firm is the control of bottleneck facilities. A firm controlling bottleneck facilities has the ability to impede access of its competitors to those facilities. We must be in a position to contend with this type of potential abuse. We threat control of bottleneck facilities as prima facia evidence of market power requiring detailed regulatory scrutiny. " Id. at ¶ 58

[25] United States v. Western Electric Co., 1989-1 Trade Cases (CCH) ¶ 68.619, 61,266 (D.D.C. June 11, 1989) ("If, for example, the Miami Herald were to decide to operate a nationwide electronic publishing operation but BellSouth engaged in discrimination and harassment with respect to the Herald's southern operations similar to that which, according to the trial evidence, AT&T was guilty of in the long distance and manufacturing fields, the Herald's customers would soon tire of it and switch to the steadier, more reliable information service of BellSouth or that of another Regional Company. This risk would be multiplied if several or all Regional Companies were engaged in "out-of-region" information services, for it would be to the obvious economic advantage of all of them to eliminate the independent information services providers by parallel action.").

strategic pricing of access or indirectly through anticompetitive service manipulation -- *e.g.,* limiting access to certain types of signalling information associated with call termination.[26]

With respect to long distance services provided in conjunction with CMRS service offerings, the concern is even more immediate. Many of the RBOCs' cellular properties are located within their local exchange service areas. Given that the vast bulk of calls originating and terminating on cellular systems pass through the local exchange, an RBOC operating a cellular system within its local exchange service area will be in a position to indirectly exercise bottleneck control with respect to cellular-originated/terminated interexchange calls. This indirect control has been termed the "mobile bottleneck:"[27]

> [T]he "Mobile Bottleneck" gives the local companies (usually the Regional Companies) the ability to control a part of virtually every interexchange cellular call, just as the Landline Bottleneck gives these companies similar, albeit more complex, control over every wired interexchange call.

And this control of course raises many of the same concerns that the more traditional local exchange/exchange access bottleneck presents:

> This Mobile Bottleneck control would be critical if the Regional Companies were allowed also to carry cellular calls on a long distance basis; these companies would then have both the power and the incentive to use this control against their competitors in the cellular long distance business. This potential discrimination directly parallels the discrimination that led to the interexchange restriction in the first place. In this way, the Mobile Bottleneck on the surface raises the same dangers as does the Landline Bottleneck.[28]

---

[26] Anticompetitive service manipulation opportunities have at the termination end of a telecommunications service have expanded as the interface between the IXC and the terminating LEC has grown increasingly more sophisticated, particularly with respect to the delivery of signalling information.

[27] United States v. Western Electric Co., 890 F.Supp. 1, 3 (D.D.C. 1995)

[28] Id.

Competitive concerns are not, however, limited to anticompetitive price and service manipulation; misallocation of costs and/or assets associated with RBOC long distance activities to RBOC monopoly operations could well be more detrimental to competition in the interexchange market. And while structural separation might render such cross-subsidization somewhat more difficult, it would not eliminate the potential. In large and complex organizations, wrongful cost/asset-shifting between competitive and monopoly activities in adjacent markets can take on myriad forms. Such a cross-subsidy would occur anytime an RBOC conferred on its long distance operation a benefit derived from its monopoly local exchange activities without adequate compensation to the monopoly sector. Such a benefit could take the form of transfers of (i) capital, (ii) facilities or equipment, (iii) personnel, (iv) research and development, (v) services or (vi) any of a variety of other items. Adequate compensation could be defined in any number of conflicting and contradictory ways. Accounting systems could be established, reports required and an occasional audit conducted to determine what benefits, at what value and for what compensation, were being conferred, but it would be fanciful to think that overburdened regulators with budgets a fraction of the size of the entities they were regulating would be able to ferret out any more than an occasional violation.

The authors of The Enduring Local Bottleneck have identified (at 194-216) a number of "hard-to-detect" wrongful cost/asset-shifting opportunities available to the RBOCs, each of which would present a unique, and often insurmountable, problem for federal and state regulators. For example, cross-subsidies could occur with a shift in the boundary between competitive and monopoly activities. Strategic investments could be made by an RBOC with the full expectation and/or knowledge that the regulatory status of the activities in which the investments were being made would be changed. Another illustration would be the use of monopoly resources to construct facilities which while usable in association with monopoly operations, could ultimately be employed in conjunction with competitive activities -- e.g., interLATA transmission facilities used for "administrative intra-company transactions," but ultimately usable by the RBOCs to provide interexchange telecommunications services.[29] Transfer or loan of personnel recruited and trained at the expense of RBOC monopoly operations to RBOC long distance activities and funding of research and development by RBOC monopoly operations are yet other examples of hard-to-detect cross-subsidization, as are cost and asset misallocations between monopoly and competitive activities based on the relative use of an asset each rather than by the economic rational for the acquisition of that asset.

In short, their continued control of local exchange/exchange access bottlenecks positions the RBOCs to disadvantage interexchange rivals even if the RBOCs are providing only out-of-region long distance services and are offering such services only through structurally-separate affiliates. The Commission recognized as much in its Competitive Carrier Fifth Report and Order when it elected to regulate as dominant RBOC provision of interstate, interexchange telecommunications until such time as an assessment of market power had been undertaken and a review of potential structural safeguards designed to curb the abuse of such power had been completed.[30] The question then is not whether the potential for anticompetitive conduct exists,

[29] As the authors of The Enduring Local Bottleneck point out, the RBOCs have over the years deployed extensive interLATA digital network switching and fiber optic transmission plant whose potential traffic-carrying capacities greatly exceed the RBOCs' internal needs. While these networks were purportedly constructed for the RBOCs' own "Official Service functions," they will likely provide the backbone for the RBOCs' in-region long distance service networks.

[30] 98 F.C.C.2d 1191 at ¶ 9, fn. 23.

but what measures should be taken to protect against such activities. Certainly, it is incumbent upon the Commission, as recognized by the Notice, to "ensure that sufficient regulatory safeguards are in place to prevent a BOC from gaining any unfair competitive advantage, either through unreasonably discriminatory practices or cross-subsidization, that could arise because of its ownership and control of local exchange facilities." As the Commission recently explained in dealing with the ramifications of a geographically-limited, well safeguarded entry by an RBOC into the interstate, interexchange market :

> We recognize that the transformation from monopoly to fully competitive markets will not take place overnight. We also realize that the steps taken thus far will not result in the immediate arrival of fully-effective competition. Accordingly, the Commission and state regulators must continue to ensure against any anticompetitive abuse of residual monopoly power, and to protect consumers from the unfettered exercise of that power.[31]

Certainly, structural separation is not a panacea. Separate subsidiaries often provide useful tools, particularly when used to complement other safeguards, in protecting against discrimination and cross-subsidization. But, as noted above, in complex organizations of the size, and with the resources, of the RBOCs, identifying and preventing misallocations of costs and/or assets between competitive and monopoly activities in adjacent markets presents difficult, and often insurmountable, problems for federal and state regulators. While use of separate subsidiaries makes it somewhat easier to track and document cost allocations and asset transfers, policing the myriad means by which the RBOCs could act anticompetitively nonetheless requires a massive commitment of regulatory resources. Given that Commission resources are stretched

---

[31] Ameritech Operating Companies: Petition for Declaratory Ruling and Related Waivers to Establish a New Regulatory Model for the Ameritech Region, FCC 96-58 at ¶ 130.

thinner today than perhaps at any prior time in the agency's history,[32] it is questionable whether the Commission has the funds, personnel and other tools necessary for this task.[33]

## B. The Applicable Separation Requirements Should Be Strengthened If RBOC Out-Of-Region Long Distance Services Affiliates Are To Be Classified As Non-dominant For Federal Regulatory Purposes

While it believes that RBOC affiliates offering out-of-region long distance services should be classified as dominant until such time as the local exchange/exchange access bottlenecks have been dismantled, if the Commission determines otherwise, TRA supports the Notice's proposal to require such entities to at least meet the Competitive Carrier separation requirements as a precondition to being accorded non-dominant status. TRA urges the Commission, however, to strengthen these separation requirements to ensure a meaningful degree of separation between the RBOCs and their out-of-region long distance services affiliates.

TRA endorses the Notice's proposal (at ¶ 13) to require the RBOCs and their out-of-region long distance services affiliates to (i) maintain separate books of account and (ii) refrain from joint ownership of transmission and/or switching facilities, and to (iii) require the out-of-region long distance services affiliates to obtain exchange and exchange access services at tariffed

---

32 Statements of Reed E. Hundt, Chairman of the Federal Communications Commission, before the Subcommittee on Commerce, Justice and State, the Judiciary and Related Agencies, Committee on Appropriations, U.S. House of Representatives (March 22, 1996).

33 For example, in a study of FCC auditing capabilities conducted in 1993, the General Accounting Office ("GAO") reported that the staff resources it had found inadequate six years earlier had declined while the agency's responsibilities for overseeing carriers' cost allocations had grown. It was GAO's assessment that "the number of FCC auditors remains inadequate to provide a positive assurance that ratepayers are protected from cross-subsidization." Indeed, GAO estimated that the FCC would only be able to conduct audits of the highest priority matters, and to undertake a full audit of major LECs once every 11 and 18 years, respectively. GAO, FCC Oversight Efforts to Control Cross-Subsidization, GAO/RCED-93-34 (Feb. 1993).

rates and under tariffed terms and conditions. TRA further agrees with the Notice's proposal (at ¶ 13) to treat the RBOC out-of-region long distance services affiliate as a "non-regulated affiliate" under the Commission's joint cost rules[34] and affiliate transaction rules[35] for exchange carrier accounting purposes.

Separate books of account are necessary to trace and document misallocations of costs and/or assets between an RBOC and its out-of-region long distance services affiliate, making it more difficult to disguise such wrongful transactions, as well as discriminatory conduct. Prohibitions against joint ownership of transmission and/or switching facilities are necessary to safeguard against the most difficult to police of non-regulated/regulated cost/asset misallocations -- *i.e.,* allocation among multiple users of common facilities by extent of usage. And a requirement that network services be provided to RBOC out-of-region long distance affiliates under tariff facilitates "arm's-length" dealings and reduces the potential for discrimination and abusive transfers of services at less than market price.[36]

---

[34] 47 C.F.R. §§ 64.901-904; Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, 2 FCC Rcd. 1298 (1987).

[35] 47 C.F.R. §§ 32.27.

[36] A requirement that RBOC out-of-region long distance affiliates take network service under tariff, however, addresses but one of a number of associated problems. Given that access rates are set substantially above cost, the RBOCs are able to inflate long distance rivals' costs while at the same time securing huge profits for themselves. As the record in CC Docket No. 94-1 establishes, access charges currently recover roughly three times the RBOCs' unrecovered economic cost of providing loop and switching services and facilities. See Comments of MCI Telecommunications Corporation filed in CC Docket No. 94-1 on December 11, 1995. Further complicating this matter is the ability of non-dominant carriers to file tariff changes on a single day's notice and without cost support. Such relaxed tariff filing requirements will render it virtually impossible for the Commission or interested parties to ascertain whether RBOC out-of-region long distance services affiliates are indeed taking network services under tariff.

Treating the RBOC out-of-region long distance services affiliates as non-regulated entities in applying the Commission's joint cost and affiliate transaction rules should safeguard against the most blatant cost misallocations and/or wrongful asset transfers, providing established standards and generating a discernible and comprehensible paper trail. The immediate need for this latter proposal is made all the more compelling by the disturbing, but predictable, findings of audits of RBOC regulated/non-regulated relationships undertaken by the Commission over the past few years.[37] The affiliate transaction rules, however, contain a number of loopholes which should be closed for this and other purposes. For example, valuation rules applicable to asset transfers are not applied to transfers of service, "prevailing company" pricing to non-regulated affiliates are inadequately constrained, and the manner in which the "cost" of services is calculated, including the determination of the appropriate profit factor, requires reformation.

TRA, however, urges the Commission to enhance its Competitive Carrier separation requirements as they apply to RBOC provision of out-of-region long distance services. Among other things, TRA recommends that the Commission (i) require separation of the credit underlying the out-of-region long distance services affiliate from that which supports the RBOC and in so doing prohibit credit arrangements which would allow recourse to the assets of the

[37] *See, e.g.,* Southwestern Bell Telephone Co., AAD 95-32, FCC 95-31 (released March 3, 1995) (lack of supporting documentation for time charged by employees of one affiliate for another, use of improper marketing allocators, improper use of the general allocator, and intra-corporate provision of services at prevailing company rates which were not reflective of costs); Ameritech Operating Companies, AAD 95-75, FCC 95-223 (released June 23, 1995) (failure to provide adequate documentation supporting assignment of costs associated with a non-regulated affiliate to regulated operations); The GTE Telephone Operating Companies, AAD 94-35, FCC 94-15 (released April 8, 1994) (misallocation of costs between non-regulated and regulated activities); BellSouth Corporation, AAD 93-127, FCC 93-487 (released October 29, 1993) (misallocation of costs between non-regulated and regulated activities).

RBOC in association with funding provided to the out-of-region long distance affiliate; (ii) prohibit the sharing of office space and personnel, requiring the RBOC and the out-of-region long distance services affiliate to maintain separate offices and to hire/appoint separate officers, directors and employees; and (iii) prohibit the sharing of customer proprietary network information and other confidential information obtained solely by virtue of either the RBOC's or the out-of-region long distance services affiliate's role as a provider of telecommunications services.

Requiring an RBOC out-of-region long distance services affiliate essentially to stand on its own for purposes of securing the funding necessary to conduct its business provides a critical separation between the monopoly local exchange and the new long distance operations of the RBOCs. Permitting an RBOC out-of-region long distance affiliate to obtain financing by pledging the assets of the RBOC as a whole allows the affiliate to share in the value derived from the local exchange/exchange access monopoly in a manner less direct, but no less consequential, than a direct asset transfer for less than adequate compensation. Prohibiting the sharing of office space and personnel minimizes the potential for one of the more insidious, and certainly more difficult to detect, forms of cost/asset misallocations. Commonality breeds cooperative activity which is generally paid for by the monopoly operation, providing the competitive activity with an unearned benefit. Finally, sharing of customer proprietary network information and other proprietary data can be one of the more detrimental forms of wrongful cost/asset shifting, particularly if the information and data relates to a competitor's customers.